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SUBJECT: ROMANIA: PARTIES' POCKETBOOK PROMISES

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SUMMARY

¶1. (SBU) Fiscal profligacy has been the leitmotif of the current parliamentary campaign. While the governing National Liberal Party (PNL) has hardly been a paragon of fiscal prudence -- ramping up social spending and allowing the expected budget deficit to rapidly increase in the third quarter -- the Liberal Democratic (PD-L) and Social Democratic (PSD) parties have more than kept pace with their campaign promises, proposing a raft of new tax cuts and spending initiatives in an effort to woo the Romanian voter. Implementing the full range of initiatives proposed by any of the parties would likely push Romania's fiscal deficit well above three percent of GDP, negatively affecting both the domestic economy and Romania's midterm euro zone aspirations. However, this being politics, no one expects all these proposals to be enacted, and the coming economic crunch will likely force a quick reality check on the government which emerges from the November 30 elections. End Summary.

NATIONAL LIBERAL PARTY (PNL)

¶2. (SBU) Perhaps the most hotly contested issue of the election campaign has been the new law granting teachers a 50 percent wage increase, and the refusal of Prime Minister Tariceanu's government to implement it (reftel A). Even as the PNL reached an agreement with the teachers to postpone a general strike until after the election, the party agreed to a demand from health sector workers to raise wages an average 10 percent in 2009. While claiming that a tight budget makes wage hikes too expensive, in truth the PNL-led government has not been idle in announcing other popular tax breaks and spending initiatives. These include a gradual cut in payroll taxes by 10 percent over the next four years, the elimination of taxes on reinvested dividends, and a temporary suspension of the new car tax for domestically produced and small imported vehicles. (Comment: The main beneficiary of the latter would likely be Renault, which produces the popular Dacia Logan model domestically at a plant in Pitesti. End Comment.) Shortly after being elected in 2004, this government implemented a 16 percent flat tax on income which has proven politically popular and which the PNL promises to keep in place if returned to office.

¶3. (SBU) Staying true to the party's interest in investment, the PNL is promising to expand state aid schemes to lure investors and to increase the capitalization of the state-owned savings bank (CEC) in order to boost lending to small and medium enterprises, measures which would require substantial spending outlays. The PNL also plans to leave in place the law requiring that six percent of GDP be spent on education. On highways, the PNL plan is ambitious, promising an additional six percent of GDP annually will be spent constructing 2,100 kilometers of new roadway by 2012. Voters, however, may be skeptical on this count given the current government's dismal road-building record over the last four years.

SOCIAL DEMOCRATIC PARTY (PSD)

¶4. (SBU) Not surprisingly, the left-of-center PSD is focused more on promising new spending than on tax breaks. The party has said it will increase the minimum wage, allocate five percent of GDP to health care, six percent of GDP to education, and subsidize residential natural gas prices. The PSD proposes to pay for all this by scrapping the current flat tax regime and replacing it with a progressive income tax. Keeping the focus on workers (and potential voters), the PSD has proposed a 25,000 euro grant to any Romanian expatriate who returns and takes a job locally. Hoping that holding the election on the Sunday of a three-day holiday weekend will lure large numbers of pensioners to the polls, the PSD has promised them major increases in pensions and a guaranteed minimum income in retirement. While pronouncements of other parties focus more on the urgent need for new road construction, the PSD has promised major investments in railways and airport infrastructure, in addition to a road building plan.

LIBERAL DEMOCRATIC PARTY (PD-L)

¶5. (SBU) President Traian Basescu's PD-L has promised the voters both continued economic growth and a rapid convergence in wages and quality of life with the rest of the EU. The focus is on shrinking and reinventing government, with a planned elimination of more than 100 taxes and duties. To make up for the revenue shortfall, the PD-L proposes to partner with the Romanian Orthodox Church to assist with the delivery of social services. A related goal is a major overhaul of the education and health systems through the devolution of power to public-private partnerships set up through local communities. The PD-L shares the consensus view that six percent of GDP should be allocated to education, and has also proposed

allocating one percent of GDP to basic research. They plan to undertake significant government reforms to increase the capacity to absorb EU structural funds, using these funds to replace some of the revenue the government loses in tax-cutting. Accessing EU funds will be critical if the PD-L hopes to match PNL promises to build 2,100 kilometers of new roads, albeit over a longer time horizon than their electoral rivals.

MACROECONOMIC OUTLOOK

¶6. (SBU) Economic analysts broadly agree that the populist promises of the campaign trail will run smack into hard realities once the votes are counted. The working assumptions about future growth on which the parties have based their platforms are looking very optimistic in light of the world financial crisis. In the last three months growth projections for Romania in 2009 have fallen from six percent or higher, down to three or four percent, a figure that could go lower still as the recession deepens in developed markets. This represents a significant slowdown for an economy which is projected to grow above eight percent in 2008, and will hinder any government trying to implement substantial new spending plans.

¶7. (SBU) It is worth noting that Romania is already obligated to send one percent of GDP to the EU and spend nearly two percent of GDP on national defense under NATO commitments. Adding in six percent for education means that 9 percent of GDP, or almost a quarter of the budget, is already committed before the budget season even starts. Furthermore, the financial crisis has already taken a toll on the GOR's credit rating, with two international rating agencies having downgraded the country's sovereign debt to junk status. With credit extremely tight in global markets, this all but forecloses the GOR's ability to finance the deficit through external borrowing in the near term. If the GOR is forced to borrow more to pay for new spending initiatives, it will be largely limited to raising funds domestically. Doing so will suck up scarce liquidity and force interest rates higher, potentially crowding out commercial borrowers and adding another major drag on growth. These harsh realities throw into question the ability of any future government to implement big new spending plans.

COMMENT

¶8. (SBU) The parties' spending proposals do reveal some elements of common consensus on Romania's most urgent needs. Critical improvements must be made in education and infrastructure if Romania is going to continue to attract foreign investors. Party leaders across the spectrum appear to recognize this, though they differ somewhat in how to tackle the issues. For a government whose growth-fueled spending already represents 38.8 percent of annual GDP, the problem is less one of resources than of ability to use existing monies effectively. Romanian state institutions broadly lack the administrative capacity to plan and implement major projects in a timely and efficient manner. As a result, at year's end the GOR traditionally scrambles to spend unused funds on wasteful consumption measures, primarily because the sclerotic bureaucracy has failed to use its allotted resources. The current government's lack of a parliamentary majority over the last year has exacerbated this problem, as it has limited the GOR's ability to push through difficult legislative initiatives. If the next government genuinely hopes to strengthen the foundation for future growth, especially in these tough economic times, it will need to focus on building up the GOR's institutional capacity to implement long-term investment plans. Otherwise, all the campaign spending rhetoric truly will be just a set of empty promises. End Comment.